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SUBJECT: BANK OF ITALY--DRAGHI'S FIRST PERSONAL AND  
RECOGNIZED TOUCH

REF: A) ROME 943; B) ROME 449

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¶1. Summary: At the Bank of Italy (BOI) annual stockholder's meeting May 31, Mario Draghi, the new central bank governor, focused primarily on the need for structural economic reforms. Emphasizing the lack of growth this decade, Draghi focused on recapturing competitiveness to achieve economic growth. He targeted reform of labor rules, the pension system, and capital markets. BOI stockholders received the governor's report with measured enthusiasm and praised Draghi's open, straight-talking style. End-Summary

Draghi's Program

¶2. Draghi outlined his plan to strengthen banking supervision, adapting it to new international rules, and make BOI a trusted, independent advisor to Parliament, the Government, and the public. He will reorganize BOI's central administration and branches, and redefine specific tasks.

Public Spending and Pensions

¶3. Governor Draghi highlighted several issues on which the Bank of Italy had not provided leadership in the past, including rationalized public spending, competitiveness, labor market issues, service-sector liberalization, legal system reform, and education. In these areas, Draghi said the BOI would encourage improvements that will promote systematic and sustained growth. The Italian economy enjoys many strengths, he said, not the least of which is stability. Draghi pointed out that the "common monetary policy has given the euro area price stability and protection from the volatility of the financial markets." However, Draghi noted "the benefits of the single currency for public finances have largely dissipated" and the remaining advantage will disappear as interest rates rise thus increasing Italy's debt service.

¶4. The Governor called for reducing the growth of public spending, which has risen over the past decade

by 2.5 percent per year and in particular called for a deficit reduction package equal to two percent of GDP (30 billion euro). Draghi further noted that Italian pension spending amounted to 15.4 percent of GDP and, more importantly, a quarter of this money was paid to pensioners under the age of 65. Draghi said that Italy needed to develop supplemental pension schemes and significantly raise the average retirement age. On health care, Draghi called for continued decentralizing of government responsibility to increase efficiency.

#### Competition

15. Governor Draghi spent considerable time addressing Italy's lagging competitiveness. "Competition" he said, "is the best agent of social justice in an economy and in a society such as Italy's, in whose history the privileges of the few have commonly been rooted in the protection of the State." He voiced support for greater labor flexibility, but called for some changes in the Biagi Law and reform of the unemployment indemnity combined with opportunity for training.

16. Draghi praised the Italian government's past privatization efforts and called for renewed vigilance to ensure that local authorities do not expand public-sector's stake in businesses. Finally, Draghi talked about Italy's under-developed financial markets. He noted that in Italy "funds raised directly in the market by firms in the form of listed shares and bonds represent only 17 percent of their financing in Italy, about a quarter less than in France and Germany; the figure is higher than 40 percent in the United States

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and close to 50 percent in the United Kingdom." In calling for the development of capital markets, Draghi emphasized the importance of pension and investment funds as key suppliers of capital.

#### Banking

17. Draghi characterized the Italian banking system as financially sound, noting that the return on equity among Italian banks is between 12 and 16 percent. Draghi remarked that the Bank of Italy would relax its notification requirements for bank acquisitions (Ref A). Draghi also announced that he will present to the next meeting of the interministerial committee for credit and savings (CICR) a proposal to reform rules governing banks' holdings in non financial companies, in line with EU regulations. He also supported more mergers in the banking sector. In the area of financial market oversight (Ref B), Draghi voiced support for transferring some powers from the central bank to other authorities, such as Consob, Italy's securities market regulator, and the Antitrust Authority. The division of responsibilities among regulators, he asserted, will improve oversight and speed the decision process.

#### Return to Growth

18. "Return to growth" was the unifying theme of Draghi's speech. According to Draghi "If slow growth persists for long, it stifles an economy's ability to innovate and saps the aspirations of the young. It is especially worrying in a country such as ours, with its adverse demographic trend and high public debt." The central bank's mission is preserving financial stability that is a necessary condition for economic

growth.

## Bankruptcy Regulation

¶9. Draghi also made a reference to recent reform of Italy's bankruptcy law. Draghi mentioned that the law introduces instruments to promote a more rapid reorganization of firms in temporary difficulty. However, Draghi also mentioned the weak points of the new regulation: it only covers half of all Italian businesses and that a significant number of companies are not eligible for cancellation of residual debts at the end of bankruptcy procedures. Moreover the law maintains criminal penalties, which perpetuates a punitive concept of bankruptcy that discourages risk taking.

## COMMENT

¶10. Almost unique among industrial world central banks, the BOI is a private institution with a Board of Governors and stockholders. Draghi's first major speech as governor was well received by an audience composed largely of bankers, industrialists, economists, and policy makers. Embassy contacts at the BOI seem genuinely happy with the change in leadership. Draghi brings to the job a more down-to-earth, accessible style than his predecessor, who left under pressure following alleged efforts to block mergers between Italian and other European banks.

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